

**Office of Chief Counsel
Internal Revenue Service
memorandum**

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to: Keith G. Medleau, Attorney
(Large & Mid-Size Business)

from: Brenda M. Stewart, Senior Counsel
Branch 6, Associate Chief Counsel
(Passthroughs & Special Industries)

subject:

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

Taxpayer =

Year =

Purpose =

\$X =

ISSUE

Whether, for purposes of § 21(c) of the Alaska Native Claims Settlement Act, as amended by § 1408 of the Alaska National Interest Lands Conservation Act, the basis in the subsurface estate sold by Taxpayer to the state of Alaska is the value of that subsurface estate when conveyed to Taxpayer or when the subsurface estate is sold to the state of Alaska?

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CONCLUSION

Under the Alaska National Interest Lands Conservation Act, the taxpayer is permitted to value the interest in the lands received pursuant to the Alaska Native Claims Settlement Act at either the time of receipt or the time of first commercial development. Under the facts set forth herein, the time of first commercial development is the date on which the subsurface estate is sold to the state of Alaska.

FACTS

Under the Alaska Native Claims Settlement Act, Pub. L. 92-203, 85 Stat. 713 (December 18, 1971) (ANCSA), as amended by the Alaska National Interest Lands Conservation Act, Pub. L. 96-487, 94 Stat. 2371 (December 2, 1980) (ANILCA), Taxpayer, a Regional Corporation, received subsurface estates in land to which Village Corporations received the surface estates. The purpose of ANCSA was to settle and extinguish Alaska Natives' aboriginal land claims by conveying to Regional Corporations and Village Corporations, over a number of years, land and other consideration.

In Year, the state of Alaska acquired property, including the property at issue here, in Taxpayer's region for Purpose.¹ The state of Alaska, relying on independent valuation companies, allocated the purchase price of the property between the surface rights owned by Village Corporations and the subsurface estate owned by Taxpayer. The amount paid to Taxpayer was \$X. No exploration or development of the subsurface estate took place between the time Taxpayer received those rights and the date on which the subsurface estate was sold to the state of Alaska.

Taxpayer valued its interest in the subsurface estate as of the date of sale to the state of Alaska, concluding that the sale constituted the first commercial development under ANCSA. This resulted in a basis of \$X, and thus no gain upon the sale. Examination challenges this valuation date, arguing that the basis of the subsurface estate should have been determined at the time the subsurface estate was conveyed to Taxpayer, resulting in taxable gain to the Taxpayer upon the sale of the subsurface estate.

LAW AND ANALYSIS

Section 21(c) of ANCSA provides that:

The receipt of land or any interest therein pursuant to this Act or of cash in order to equalize the values of properties exchanged pursuant to subsection 22(f) shall not be subject to any form of Federal, State, or local taxation. The basis for computing gain or loss on subsequent sale or

¹ Taxpayer retained directional access to that portion of the subsurface estate below 250 feet beneath the surface to the extent development of such right did not infringe on the surface use for Purpose.

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other disposition of such land or interest in land for purposes of any Federal, State, or local tax imposed on or measured by income shall be the fair value of such land or interest in land at the time of receipt.

The provisions of ANCSA were clarified by Congress in 1980 when ANILCA was enacted. Section 1408 of ANILCA amended § 21(c) of ANSCA to provide that:

(c) The receipt of land or any interest therein pursuant to this Act or of cash in order to equalize the values of properties exchanged pursuant to subsection 22(f) // 43 USC 1621. // shall not be subject to any form of Federal, State, or local taxation. The basis for determining gain or loss from the sale or other disposition of such land or interest in land for purposes of any Federal, State, or local tax imposed on or measured by income shall be the fair value of such land or interest in land at the time of receipt, adjusted as provided in section 1016 of the Internal Revenue Code of 1954, // 26 USC 1016. // as amended: *Provided, however, That the basis of any such land or interest therein attributable to an interest in a mine, well, other natural deposit, or block of timber shall be not less than the fair value of such mine, well, natural deposit, or block of timber (or such interest therein as the Secretary shall convey) at the time of the first commercial development thereof*, adjusted as provided in section 1016 of such Code. For purposes of this subsection, the time of receipt of land or any interest therein shall be the time of the conveyance by the Secretary of such land or interest (whether by interim conveyance or patent)." (emphasis added).

By enacting ANCSA, Congress expressed its intent that in exchange for the surrender of land claims by Alaska Natives, the United States would transfer land to Alaska Natives under ANSCA tax-free. Furthermore, under this provision lands were conveyed to Alaska Natives with the highest possible tax basis or, for subsurface estates, a "fresh start basis," to limit future income tax liability if the lands were later converted into cash or other property.

ANILCA clarified ANCSA § 21(c) by creating a "modified fresh start basis" rule to allow Alaska Natives to receive lands with mineral reserves with a basis that is not less than the fair market value of the land when the true commercial value of the mineral reserves is ascertained, that being the time of first commercial development. Subsurface rights, such as those conveyed to Taxpayer here, are mineral rights. See, e.g., Chugach Natives, Inc. v. Doyon, Ltd., 588 F.2d 723, 728, n. 16 (9th Cir. 1978).

Congress' intent in enacting ANILCA § 1408 is further explained by S. Rep. No. 96-413, 96th Cong., 1st Sess. 1979, which provides:

...The purpose of the provision is to eliminate an ambiguity in the language of section 21(c) of the Alaska Native Claims Settlement Act as to precisely

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which date is intended by the term 'time of receipt', and also to eliminate a potential inequity in the tax treatment accorded different native corporations. The effect of the Amendment is to require the basis of land received under the Act to be determined on one of two dates. The general rule is that the basis of land received shall be the fair market value (FMV) at the time of receipt. The Amendment provides that the time of receipt shall be defined as 'the time of the conveyance' by the secretary of the interior, regardless of whether the title document is a patent or an interim conveyance.

The Amendment also provides that the basis of mineral deposits and timber shall be the FMV at the time of first commercial development.

The determination of the basis of mineral deposits and timber is postponed until first commercial development, because the existence or the extent and quality of a mineral deposit may not be known at the time of receipt. The uncertainty as to the existence of a mineral deposit or as to extent and quality of a deposit would be a significant effect on value...

The legislative history of ANSCA and ANILCA indicates that Congress clearly intended that Alaska Natives be able to value interests in land conveyed under ANCSA at either the time of conveyance or the time of first commercial development. Furthermore, the Senate Report clarifies that the basis of mineral deposits must be valued at the time of first commercial development once any mineral reserves are ascertained. Thus, the intention of Congress in enacting ANCSA and ANILCA is to grant Alaska Natives the highest possible basis in the land and attached mineral reserves that they receive under ANCSA.

Additionally, the Senate Report contains the following language regarding the meaning of "first commercial development":

... For these purposes, the time of first commercial development shall be the first day of the taxable year in which, (1) a deduction for depletion is allowed or allowable, (2) gain or loss is realized from a disposal of minerals or timber with a retained economic interest, or (3) minerals in place or standing timber are sold or exchanged...²

In the instant case, the language of ANCSA § 21(c) makes it is clear that Taxpayer may value the subsurface estate on either the date of conveyance or at the time of first commercial development. While Examination has argued that the alternative basis determination date of first commercial development is available only

² The Service has ruled that this language is not to be interpreted as defining the time of first commercial development as the first day of the taxable year, but rather as the date that first commercial development actually begins. PLR 9147002.

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when the commercial development occurs while the property is held by the Alaska Native Corporation, the Senate Report quoted above makes clear that Congress considered the sale or exchange of minerals in place to be a possible "first commercial development." Taxpayer has selected the time of first commercial development, here the sale of the subsurface estate, as the date of valuation for the subsurface estate. It is clear under ANCSA that Taxpayer's basis in the subsurface estate is the higher of the value of the subsurface estate on either the date of conveyance or the time of first commercial development. Taxpayer's basis in the subsurface estate is the value on the date the subsurface estate is sold to the state of Alaska, or \$X.

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